No. 490

In the Supreme Court of the United States

OCTOBER TERM, 1943

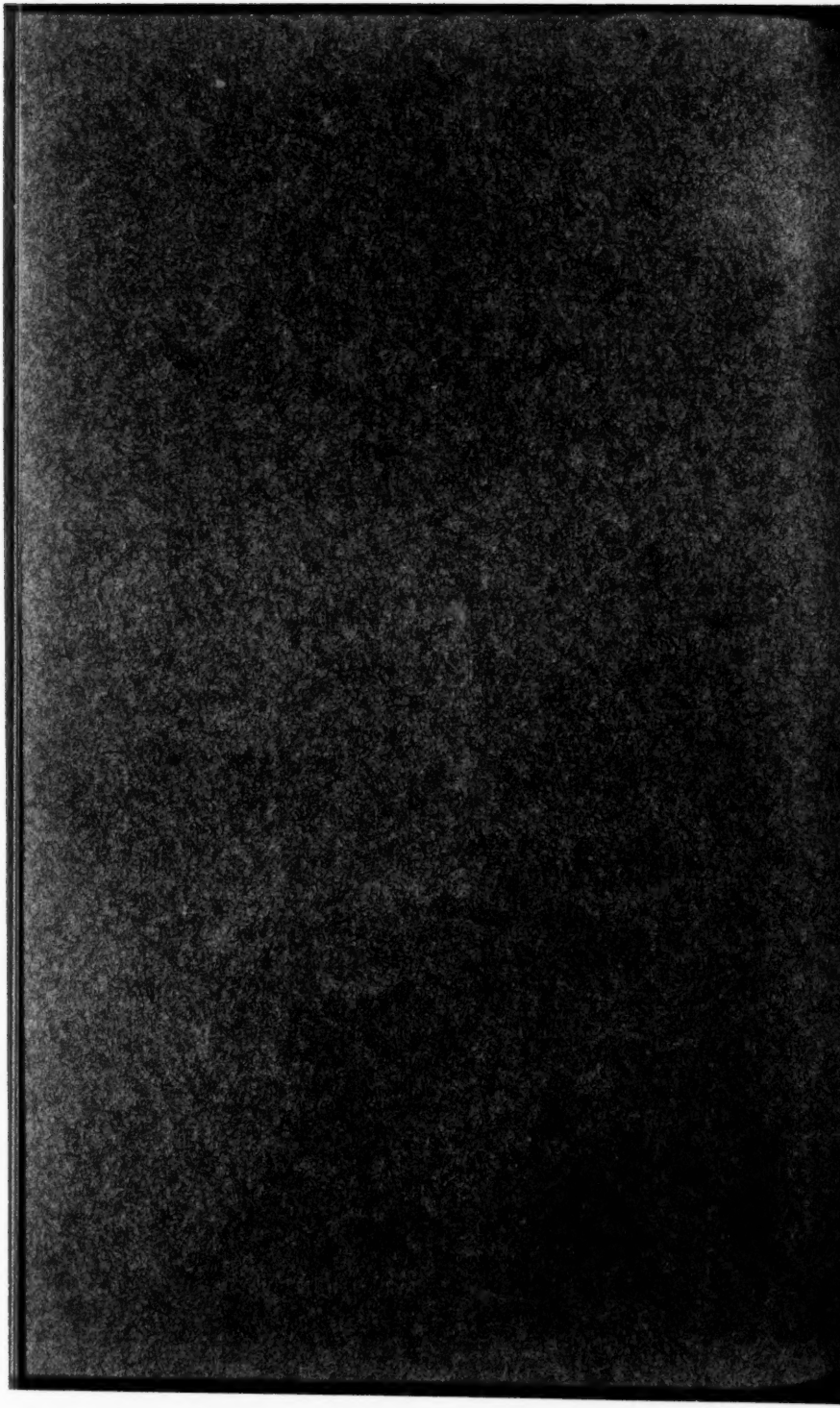
THEO. PRODUCTS CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



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No. 490

TRICO PRODUCTS CORPORATION, PETITIONER

v.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 46–104) is reported in 46 B. T. A. 346. The opinion of the Circuit Court of Appeals (R. 370–375) is reported in 137 F. 2d 424.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 19, 1943 (R. 390), following denial of a petition for rehearing on August 18, 1943 (R. 387). The petition for a writ of certiorari was filed on November 16, 1943. The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, notwithstanding the taxpayer's denials, there was substantial evidence to support the determination of the Board of Tax Appeals that during the years 1934 and 1935 the taxpayer's earnings were permitted to accumulate, instead of being distributed, in order to avoid surtaxes upon its shareholders.

2. Whether the Board of Tax Appeals erred (a) by failing to make an express finding that the purpose of avoiding surtaxes was a substantial factor inducing the taxpayer's accumulation of earnings, or (b) by misapplying the presumption established by subdivision (b) of Section 102 of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 17–21.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 47–73) may be summarized as follows:

The taxpayer was incorporated in 1920 under the laws of the State of New York. Its principal activities had been the manufacture and sale of automatic windshield wipers in Buffalo. It was organized to take over the assets and business of a former company organized by the same

stockholders in 1917, which had been engaged primarily in making hand-operated windshield wipers. Between 1920 and 1927 the business grew and further capital was put into the company from time to time by the stockholders, who personally borrowed money and bought the company's stock. An automatic windshield wiper was developed in 1921 which was the foundation of the taxpayer's subsequent success and prosperity. (R. 47.)

The windshield wiper device was covered by patents, of which the principal ones were owned prior to October 1927 by John R. Oishei, the president and general manager of the company. The basic patents expired in 1942. In 1927 the taxpayer had about 100 patents. It has always sought improvements, and has approximately 600 additional patents, most of which are related to windshield wipers, and which extended beyond 1942. (R. 48.)

After 1931 the taxpayer supplied 100 per cent of the total automatic windshield wiper requirements of all automobile production in the United States and Canada. During the period 1937 to 1939, inclusive, its percentage of net profits to net sales ranged from 27.1 to 32.7. Increased sales have always resulted in increased profits in the taxpayer's business. (R. 67.) Most of taxpayer's sales were to General Motors, Chrysler, and Ford, which took about 75 to 80 per cent of taxpayer's output (R. 68). The market for taxpayer's pres-

ent products has been controlled entirely by automobile production (R. 69). Since 1927 the taxpayer has owned the patent for the automatic windshield wiper, which was the principal source of its earning power and gave it its monopoly (R. 70).

During the taxable year 1934 the taxpayer's net earnings were $1,771,558, of which $937,485.62 was distributed in dividends; during the taxable year 1935 the taxpayer's earnings were $3,567,404, of which $925,322.70 was distributed in dividends (R. 58, 61). On December 31, 1933, at the beginning of the taxable period, the taxpayer's accumulated gains and profits were "not less" than $5,252,534.99. On December 31, 1935, at the end of the taxable period here involved, the taxpayer's accumulated gains and profits were not less than $8,762,708.19. By December 31, 1939, they had arisen to not less than $17,116,605.36. (R. 58.) The taxpayer's investments in securities, consisting principally of Government bonds and stocks of other corporations, amounted to $1,097,571.40 at the end of 1929. They were $4,026,952.38 at the end of 1933; $6,859,067.96 at the end of 1935; and $11,353,779.10 at the end of 1939. (R. 59.)

In 1927, prior to a reorganization in October of that year, the taxpayer's capital stock consisted of 8,000 shares of common. It had 21 stockholders who were in general the same group which organized the taxpayer in 1920 and had been

associated with John R. Oishei prior to that time.[1] (R. 48.)

In the summer of 1927 some bankers proposed a recapitalization of the taxpayer (R. 49). Instead of 8,000 shares, there were to be 675,000 shares, without par value (R. 50). The bankers agreed to purchase 175,000 shares for $4,225,000 in cash, which was to be ratably distributed among the stockholders (R. 50–51). Of the remaining 500,000 shares, 450,000 shares were not to be entitled to dividends, unless the dividends exceeded $2.50 per share in any one year, and until the earnings reached certain limits (R. 51–52).

The syndicate agreement provided for the release of restricted shares as free shares in the following terms (R. 51–52):

> It is agreed that commencing January 1, 1928, up to 112,500 deferred shares may be exchanged for free shares accordingly as net earnings of the Company for the calendar year 1927 or for any year thereafter shall be equal to $5 per share upon the sum of the free shares then outstanding plus the number of free shares required for such exchange and in like manner commencing January 1, 1929 additional deferred shares up to 112,500 may be exchanged accordingly as the net earnings

[1] From 1920 until the date of the taxpayer's reorganization in 1927 John R. Oishei and Peter C. Cornell, together, owned more than 50 percent of the taxpayer's stock (R. 298).

of the Company for the calendar year 1928 or for any year thereafter are equal to $6 per share on the sum of the free shares plus the free shares required upon such exchange and in like manner the remaining 225,000 deferred shares may be exchanged accordingly as the net earnings of the Company for the calendar year 1929 or for any year thereafter are equal to $9 per share on the sum of the then outstanding free shares plus free shares required upon such exchange; provided that as condition precedent to such exchange in 1928, dividends at the rate of $2.50 per share shall have been paid on the free shares from date of issuance and provided that at the date of each successive exchange herein provided for, dividends aggregating $2.50 shall have been declared and paid during the then next preceding twelve months upon the free shares then outstanding.[2]

[2] The formula according to which the restricted stock was to be released under the contract between the original stockholders and the bankers is substantially as follows (R. 51–52, 61):

Number of shares (from group of 450,000 to be released)	Date	Earnings necessary to release first share	Earnings necessary to release last share
112,500	Beginning January 1, 1928	$1,125,005	$1,687,500
112,500	Beginning January 1, 1929	2,025,006	2,700,000
225,000	Beginning December 31, 1929	4,050,009	6,075,000

The 450,000 restricted shares were to be placed in a voting trust under the agreement with the bankers (R. 50). The trustees of the voting trust were John R. Oishei, Peter C. Cornell, S. H. Evans, and William P. Haines. The stockholders who entered into this agreement were the above-named trustees and Ieuan Harris and B. F. Oishei. (R. 53.) The original stockholders also retained 50,000 shares of free stock (R. 55).

In 1929 Trico Securities Corporation [3] was organized to take the place of the voting trust and

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The number of restricted shares released in the respective years resulting from the application of the formula to the earnings is as follows (R. 61):

Year	Earnings	Shares released after close of year	Total shares released in each group per formula
1927	$1,372,303	49,460	
1928	1,778,475	63,040	112,500
1929	2,249,947	37,491	
1930	1,908,415	None	
1931	1,762,550	None	
1932	964,964	None	
1933	1,418,277	None	
1934	1,771,558	None	
1935	3,567,404	75,009	112,500
1936	4,184,560	14,951	
1937	3,792,244	None	
1938	2,319,854	None	
1939	3,540,609	None	14,951
	Total shares released	239,951	

[3] The *Trico Securities Corp.* v. *Commissioner*, 41 B. T. A. 306, in which it was held that that corporation was not formed or availed of for the condemned purpose under Section 104 of the Revenue Act of 1932. The taxable year was 1933. No

acquired all of the then restricted stock amounting to 337,500 shares from the original stockholders, who became stockholders of Trico Securities Corporation in proportion to their holdings of the restricted shares [4] (R. 56).

The total number of shares, free and restricted, held by Trico Securities Corporation during the years 1929 to 1937 is as follows (R. 56–57):

	Restricted shares	Free shares	Total
December 31, 1929	337,500		337,500
December 31, 1930	300,009	60,601	360,610
December 31, 1934	300,009	57,260	357,269
December 31, 1935	300,009	57,260	357,269
December 31, 1936	225,000	132,269	357,269
December 31, 1937	210,049	147,220	[5] 357,269

Each release of restricted stock has increased the dividend participation of the original stockholders. When and if all restricted shares are

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appeal was taken by the Commissioner, presumably in the view that there was substantial evidence to support the Board's decision.

[4] John R. Oishei and Peter C. Cornell together held more than 50 percent of the stock in Trico Securities Corporation during the period from 1930 through 1937 (R. 355).

[5] Since the taxpayer had 675,000 shares of stock outstanding, it will be seen that Trico Securities held 50 percent of taxpayer's stock in 1929 and more than 50 percent in the years 1930 through the taxable years. Therefore, John R. Oishei and Peter C. Cornell, through their control of Trico Securities, effectively controlled the taxpayer during the period from 1930 through 1937. In addition to their holdings in Trico Securities, they held substantial amounts of taxpayer's free shares in the period from 1929 through 1935 (R. 363–364).

released, the original stockholders will receive approximately 75 percent of all dividends distributed. The taxpayer had some 1,500 stockholders in 1928, after the bankers had sold stock to the public, and their number had increased to about 2,200 in 1935. (R. 57.)

At the time of the reorganization and sale of stock to the bankers in 1927 the bankers required that taxpayer obtain title to the patents used by the corporation then owned by John R. Oishei, which include the basic patent on the automatic windshield wiper. They accomplished this by giving John R. Oishei a profit-sharing agreement. The payments to John R. Oishei under the agreement were charged to expense. Those payments amounted to about $379,000 in 1934, and about $649,000 in 1935. (R. 70.)

All of the large individual stockholders of taxpayer were in the taxable years, and for several years prior thereto, men of substantial wealth. They had large incomes each year on which they paid federal income taxes. They knew, in general, that the tax rate increased as income increased, and that if additional distributions of dividends had been made by petitioner during the taxable years they would have had to pay more federal surtaxes. (R. 72.)

The surtaxes avoided by the following stockholders by reason of the failure of taxpayer to distribute the undistributed portion of its net book income are as follows (R. 72):

	Surtax avoided, 1934	Surtax avoided, 1935
Trico Securities Corporation	$53, 978. 54	$433, 417. 28
John R. Oishei	29, 419. 45	97, 346. 23
Peter C. Cornell	28, 654. 78	93, 825. 49
S. H. Evans	6, 128. 65	30, 706. 89
Ieuan Harris	15, 968. 00	53, 145. 46
W. J. Chellew	367. 07	1, 245. 47
Total	134, 516. 49	709, 686. 82

At the close of 1934 and 1935 the above six stockholders owned nearly 74 percent of the outstanding capital stock of taxpayer. By reason of purchases by taxpayer of treasury stock from the public the holdings of these stockholders had increased to approximately 78 percent at the close of 1937. (R. 73.)

Had taxpayer distributed the undistributed portion of its net book income and had the share so received by Trico Securities Corporation been distributed by it, the additional surtaxes payable by the stockholders indicated below would be as follows (R. 73):

	Additional surtax	
	1934	1935
John R. Oishei	$108, 720. 03	$356, 734. 85
Peter C. Cornell	97, 924. 94	322, 260. 16
S. H. Evans	35, 166. 41	134, 590. 02
Ieuan Harris	19, 981. 40	65, 878. 65
C. H. Oishei	12, 008. 17	69, 071. 52
W. J. Chellew	1, 754. 45	7, 455. 37
Total	275, 564. 40	955, 999. 57

The above six stockholders during the taxable years owned approximately 87 percent of the outstanding capital stock of Trico Securities Corporation. Together with the other few original stockholders or relatives they owned approximately 100 percent (R. 73).

During the taxable years taxpayer permitted its gains and profits to accumulate beyond the reasonable needs of its business (R. 73).

During the taxable years taxpayer was availed of for the purpose of preventing the imposition of the surtax upon its shareholders, and the shareholders of another corporation, through the medium of permitting its gains and profits to accumulate instead of being divided or distributed (R. 73).

Pursuant to the findings, the Board sustained the Commissioner's determination that the corporation had been availed of in the taxable years 1934 and 1935 for the purpose of preventing the imposition of surtaxes upon its stockholders. The Circuit Court of Appeals affirmed the decision.

ARGUMENT

1. The decision of the court below is correct. Section 102 of the Revenue Act of 1934 (Appendix, *infra*) provides for the levy of a substantial tax on the "adjusted net income" of a corporation,[6] if such corporation is availed of for the pur-

[6] Under the earlier Revenue Acts the tax was levied on the *net income* of the corporation. The 1934 Act made allow-

pose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting gains and profits to accumulate instead of being divided or distributed. In cases arising under this section the Board's determination is conclusive if supported by substantial evidence. *Helvering* v. *Stock Yards Co.*, 318 U. S. 693; *Helvering* v. *Nat. Grocery Co.*, 304 U. S. 282. Since the Board of Tax Appeals decided in this case that the corporation was availed of for the condemned purpose, the only factual question before the court below was whether there was substantial support for the Board's determination.

The Board's detailed findings clearly support its ultimate determination under Section 102, as well as under Article 102 of Treasury Regulations 86 (Appendix, *infra*). The taxpayer, indeed, does not dispute the finding that the taxpayer's earnings were permitted to accumulate beyond the reasonable needs of the business (Pet. 20; Br. 27).[7] Although on the surface the tax-

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ance for any dividends distributed, which were to be deducted from the corporation's net income. The balance was called "adjusted net income." See subsection (c) of Section 102. See also subsection (d) of Section 102 which provides a method whereby stockholders may avoid application of Section 102 to their corporation by paying their pro rata share, whether distributed or not, of the corporation's "adjusted net income."

[7] By Section 102 (b), this fact is declared to be "prima facie evidence of a purpose to avoid surtax." Quite apart from Section 102 (b), and any questions which might be

payer's stock was "widely held" (Pet. 23), the corporation was controlled by a small group of wealthy men, who profited heavily by the taxpayer's failure to pay out its earnings in dividends. The Board heard and considered the evidence introduced to explain the accumulations on a ground unrelated to tax considerations, but concluded that "there is an absence of conviction" in these explanations (R. 97). Obviously, the Board was not required to accept the taxpayer's denials at face value and thus abdicate its position as the trier of the facts. See *Helvering* v. *Stock Yards Co., supra; Helvering* v. *Nat. Grocery Co., supra.* The Circuit Court of Appeals gave the taxpayer the full review of the Board's determination to which it is entitled, and concluded (R. 374) that—

> The result reached by that tribunal was certainly a reasonable one arrived at with due regard for the right of the parties to be heard fully and fairly upon all relevant issues.

Accordingly, there is no occasion for further review here.

2. The taxpayer contends that a proper construction of Section 102 requires a finding by the Tax Court that the avoidance of surtaxes on shareholders was a "substantial factor" inducing

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raised as to its scope and effect (Pet. 20; Br. 31–34), the fact of an accumulation in excess of the reasonable needs of the business has powerful probative force.

the accumulation of profits (Pet. 22, Br. 28–36). Even if that be so, the Board's finding that the taxpayer was availed of for the condemned purpose (R. 73) would seem to carry with it a determination that the avoidance of surtaxes was a substantial factor inducing the accumulation of profits. Such a finding is also implied in its express decision that the detailed findings "preponderate" (R. 100) in favor of the Commissioner's position that the corporation was availed of for the condemned purpose. It is true that the Board may not have regarded the tax motive as the only purpose. It was not obliged to do so.

In *Helvering* v. *Stock Yards Co., supra,* dealing with the corresponding provision of earlier Revenue Acts, the practice of accumulating profits had been adopted before the first income tax was enacted. Nevertheless this Court held that if the purpose of avoiding surtax induced, or aided in inducing, the continuance of the practice, the Board's conclusion that the corporation was availed of for the condemned purpose was justified. 318 U. S. 693, 699. Therefore it would seem that if the avoidance of surtax was a reason, or one of the reasons, for accumulating gains, the requirements of the statute are met. There is nothing in the statute or in the decisions of this Court in the *Stock Yards Co.* case, *supra,* or in the *Nat. Grocery Co.* case, *supra,* to indicate that the Board must make an express finding that the avoidance of surtaxes

was a "substantial factor" inducing the accumulation of profits. Nor is there reason to believe that the Board applied any test different from that applied by this Court in those cases.

3. The taxpayer argues that the court below erroneously applied subdivision (b) of Section 102 of the Revenue Act of 1934 by treating the finding that profits were accumulated beyond the reasonable needs of the business as *prima facie* evidence of the existence of the condemned purpose surviving the introduction by taxpayer of evidence of the purpose inducing the accumulation, and that this conflicts with the decision of the Ninth Circuit in *Hemphill Schools* v. *Commissioner,* 137 F. 2d 961 (Pet. 22–23, Br. 32–36). But whatever may be said as to the operation of subdivision (b) or the decision in the *Hemphill Schools* case,[8] the controlling fact here is that the Board's determination plainly depends upon the evidence alone, unaided either by the "presumptions" established by Section 102 (b) or the more general presumption of correctness which attaches to determinations of the Commissioner of Internal Revenue. After discussing in the first part of its opinion (R. 89) the prima-facie-evidence test provided by subdivision (b), the Board then considered the evidence without regard to

[8] In fact, it appears that the Ninth Circuit in the *Hemphill Schools* case was referring to the presumption of correctness which supports the Commissioner's determinations in tax cases generally rather than to the force of the "presumption" of subdivision (b), once an adequate factual basis has been laid for it. See 137 F. 2d at pp. 963–964.

presumptions or even burden of proof (R. 97-100). The Board observed in this connection (R. 97):

> But forsaking narrow procedural matters such as presumptions and burden of proof, we can not read the record as a whole without being satisfied that a preponderance of the evidence affirmatively establishes that petitioner was "availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation through the medium of permitting gains and profits to accumulate instead of being divided or distributed."

It is therefore unnecessary to consider the scope of subdivision (b), and the claim of conflict is groundless.

CONCLUSION

The decision of the court below is correct. There is no conflict of decisions. The petition for certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
MORTON K. ROTHSCHILD,
ALVIN J. ROCKWELL,
Special Assistants to the Attorney General.

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